

WASHINGTON

November 13, 1985

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EPC*

MEMORANDUM FOR JAMES A. BAKER III

FROM: EUGENE J. McALLISTER *EM*

SUBJECT: Presidential Decision Memorandum on Semiconductors

A decision memorandum for the President reflecting the Economic Policy Council's discussion regarding the Strike Force's recommendations on semiconductors is attached.

I did not register any vote for Treasury. You had indicated to me earlier that you were inclined not to take a position.

The paper has been circulated to all members of the EPC for their comments and votes.

cc: Alfred H. Kingon
Richard G. Darman

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INSTRUCTIONS APPLY

THE WHITE HOUSE
WASHINGTON

November 13, 1985

MEMORANDUM FOR THE PRESIDENT

FROM: THE ECONOMIC POLICY COUNCIL

SUBJECT: International Trade in Semiconductors

In your September 23 speech on trade, you unveiled an interagency strike force designed to search out instances of unfair foreign trade practices and to offer recommendations to remedy those practices. The Strike Force, under the chairmanship of Secretary Baldrige, has presented the Economic Policy Council with its findings on unfair Japanese trade practices in the semiconductor industry and recommendations to address these practices.

The Economic Policy Council has reviewed the Strike Force's findings and recommendations, and we are offering you our views on the issue of unfair Japanese practices in semiconductors.

BACKGROUND

The Strike Force looked at trade in semiconductors for two reasons: (1) trade in semiconductors is very large, \$25 billion worldwide in 1984; and (2) semiconductors are the heart of computers, robots, and industrial process controls, and are a key to technological leadership.

U.S. semiconductor manufacturers argue that the Japanese engage in two kinds of unfair trade practices:

- o Dumping semiconductors into the U.S. market, and thus damaging the U.S. semiconductor industry.
- o Pursuing policies and practices that limit U.S. access to the Japanese semiconductor market, the second largest in the world.

After a long period of dominance in this technology, the U.S. now shares leadership with Japan and is falling behind in the newest generation of semiconductors. Our position is a result of many factors, some of our own making. But a prominent cause appears to be Japanese efforts to develop a strong export industry. Their strategy has been to exclude U.S. companies from their home market, while gaining share in ours by aggressive pricing policies. Japan has expanded production capacity rapidly; as a result the industry is now oversupplied, and prices are declining.

The U.S. share of the Japanese market has remained at 10 to 11 percent in recent years, despite strong efforts by U.S. companies to expand. By contrast, the Japanese share of the U.S. market is now about 16 percent, having grown from about 6 percent in 1978. In Europe, where the U.S. and Japanese products compete head-to-head, U.S. companies have 55 percent of the market.

UNFAIR TRADE ACTIONS INITIATED BY INDUSTRY

U.S. industry has taken a number of actions under U.S. trade law:

- o Micron Technology has filed a dumping charge on 64K RAM (random access memory) chips.
- o Intel, Advanced Micro Devices (AMD) and National Semiconductor have filed antidumping charges on EPROM (erasable programmable read only memory) chips. The ITC recently found in a preliminary determination that U.S. producers have been injured by Japanese dumping of EPROMs.
- o The Semiconductor Industry Association (SIA) has filed a Section 301 case claiming that Japan restricts market access and engages in predatory pricing.

In addition, two antitrust actions related to Japanese predatory pricing practices in the U.S. markets are underway.

In accordance with your policy, we are committed to assure the vigorous pursuit of legal remedies addressing unfair trade practices -- and we are doing so in all these cases.

RECOMMENDATIONS

The Strike Force forwarded three recommendations to the Economic Policy Council. If adopted, these would supplement the actions initiated by the industry as noted above.

1. The Department of Commerce would initiate an antidumping case on 256K RAMS, assuming that the Department of Commerce finds reasonably solid evidence that there is indeed dumping and that the ITC is likely to find injury.
2. The USTR would accelerate its consideration of the SIA's Section 301 case. If USTR finds a Section 301 violation, it would seek a "package" settlement with Japan.
3. The Administration would confirm our intention to retaliate if negotiations pursuant to the Section 301 case are not concluded to our satisfaction.

A more complete discussion of the recommendations follows.

Recommendation 1: Self-initiate an antidumping case on 256K RAMs assuming that the Commerce Department finds reasonably solid evidence that there is indeed dumping and that the ITC is likely to find injury.

U.S. law allows the Commerce Department to self-initiate antidumping cases. The Customs Service must impose duties on foreign products when: (1) the ITC determines that because of such imports, the U.S. industry is injured or threatened with injury; and (2) the Commerce Department determines that an import is being sold in the U.S. at "less than its fair value." "Less than fair value" means: (1) Japanese prices in the U.S. are below home market prices; or (2) Japanese prices in the U.S. are below the cost of production in Japan.

A Commerce Department preliminary investigation indicates that Japanese semiconductor manufacturers are dumping 256K RAMs in the U.S. market at less than their cost of production. Japanese 256K RAMs sell in the U.S. for \$2.00 to \$2.50 while the fully allocated cost of production in Japan cannot be less than \$2.60 and may be as high as \$4.00.

The Commerce Department analysis also points to a probable injury finding by the International Trade Commission based on substantial evidence of lost sales, major financial losses, massive layoffs, and U.S. companies exiting from the market entirely.

Antidumping cases are usually filed by the affected industry. The U.S. industry has not filed a case on 256K RAMs, apparently because it fears a boycott from its customers in Japan and possible retaliation by the Japanese Government. (We have no evidence as to the validity of this threat.)

Advantages

- o Self-initiating an antidumping case would send a message to Japan, U.S. industry, and the Congress that the Administration continues to be concerned about unfair trade practices, particularly in critical technology industries.
- o Self-initiating an antidumping case may strengthen our position in negotiating a solution to the market access and predatory pricing practices raised in the Section 301 case.
- o Failure to self-initiate a case when evidence of dumping exists could subject the Administration to renewed charges of failure to use the discretion provided in trade law.

Disadvantages

- o Self-initiating an antidumping case could subject the U.S. to charges of politicizing antidumping cases, possibly damaging the perceived neutrality of Commerce investigations.
- o Self-initiating an antidumping case that the ITC ultimately finds unwarranted could discredit self-initiation as a practice to emphasize Presidential interest in correcting unfair trade practices.
- o A successful case would lead to at least a temporary increase in chip costs to U.S. users. However, because semiconductors account for a small proportion of the final costs of most high technology products, e.g. computers, the cost increase should be extremely small.

Recommendation 2: USTR would accelerate its consideration of the SIA's Section 301 case. If USTR finds a Section 301 violation, it would seek a "package" settlement with Japan.

The Semiconductor Industry Association's (SIA) filing of a 301 petition is the most recent step in a series of negotiations begun in 1982 by the U.S.-Japan High-Technology Working Group over market access in Japan. This group negotiated two agreements that were approved by the cabinets of both countries. These agreements committed Japan to providing access in Japan similar to that enjoyed by Japanese companies in the U.S. The Japanese government also undertook to encourage its companies to develop long-term relationships (as opposed to mere "spot" buying) with U.S. suppliers.

When it became apparent in June 1984 that negotiations to fulfill the promise of greater U.S. access to Japan were failing, the SIA consulted with U.S. negotiators about filing a 301 case to put pressure on Japanese negotiators. The United States Government encouraged the filing with the intent of using it to negotiate better access.

In our efforts to resolve the Section 301 case, we could address a number of issues including market access and predatory pricing. It might be possible to pursue a "package" of Japanese actions to remedy their unfair practices. Such a package might include an agreement by the Japanese to provide greater access to its market and to cease predatory pricing in return for dropping the antidumping and Section 301 cases.

Advantage

- o A successful 301 case, particularly if the Japanese accept a "package" solution, would address the major concerns of the U.S. industry: greater access to the Japanese market and a cessation of predatory pricing in the U.S. market.

Disadvantage

- o Market access is a vaguely defined term. Essentially we are looking for increased U.S. market share. A deal would probably lead to some, albeit tacit, agreement on market share, which is contrary to the Administration's free market principles.

Recommendation 3: The Administration will confirm our intention to retaliate if negotiations pursuant to the Section 301 case are not concluded to our satisfaction.

This intention is implicit in a Section 301 case. The recommendation is to make the implicit threat explicit.

Advantage

- o The history of U.S.-Japan discussions on market access is one of failure. An explicit statement of our intention to retaliate is necessary to convey to the Japanese that we mean business.

Disadvantage

- o Making the threat of retaliation explicit raises the stakes if retaliation is necessary. Retaliatory action that would be perceived by Congress and our trading partners as sufficient under an implicit threat may be regarded as inadequate under an explicit threat.

Note: Without specifying what retaliatory measures would be adopted -- even if only for our internal use -- it is not clear within the Administration or to Japan what this option would mean. To the extent that it means closing our market to certain very high technology Japanese products (as recommended by some and strongly opposed by others), it would have adverse national security effects.

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DECISIONS

Recommendation 1: Self-initiate an antidumping case on 256K RAMs assuming that the Commerce Department finds reasonably solid evidence that there is indeed dumping and that the ITC is likely to find injury.

_____ Approve

_____ Disapprove

(Supported by State, Defense, Justice, Agriculture, Commerce, Labor, Transportation, Energy, USTR, and NSC. Opposed by OMB and CEA.)

Recommendation 2: USTR would accelerate its consideration of the SIA's Section 301 case. If USTR finds a Section 301 violation, it would seek a "package" settlement with Japan.

_____ Approve

_____ Disapprove

(Supported by State, Defense, Justice, Agriculture, Commerce, Labor, Transportation, USTR, and NSC. Opposed by OMB and CEA.)

Recommendation 3: The Administration would confirm our intention to retaliate if negotiations pursuant to the Section 301 case are not concluded to our satisfaction.

(Supported by State, Justice, Agriculture, Commerce, Transportation, and USTR. Opposed by Defense, OMB, and CEA.)

_____ Approve

_____ Disapprove

James A. Baker III
Chairman Pro Tempore